Syllabus

Course Overview
The content of Economics 234C combines of several strings of research in financial economics. First, the course provides a theoretical and empirical introduction of the core topics in Corporate Finance, including: internal corporate investment, external corporate investment (= mergers & acquisitions); capital structure and financial contracting; bankruptcy; corporate governance. Second, the course puts a major emphasis on empirical methodology in applied microeconomics, some of which has not even been applied in Corporate Finance (so far). As such, the course will link to empirical literature in labor economics, public finance, development economics and other fields of applied micro. Third, the course emphasizes research in Behavioral Corporate Finance. Behavioral Corporate Finance is a novel and growing area of research that aims at integrating insights from psychology into our understanding of financial decision-making in firms.

Concretely, the course differs from traditional courses (and textbooks) in Corporate Finance as follows:

(1) Topics related to neighboring fields (e.g. labor, development, public finance) and to corporate governance issues will receive more attention, for example the role of the media. We will cover a number of papers which are not part of the traditional corporate finance curriculum. As such, the course is intended to help doctoral students whose research focuses on those neighboring fields to explore links to financial economics and to benefit, for example, from data and methodology in finance. And it is also intended to introduce doctoral students in finance to methodologies and related research in those related fields.

(2) We will cover research in Behavioral Corporate Finance wherever it speaks to the current topic. Behavioral Corporate Finance comprises (i) research on rational managerial decision-making in light of investor sentiment, e.g. market timing of security issuances, and (ii) research on biased managerial decision-making, e.g. the role of managerial overconfidence in merger decisions.

(3) The course is likely to be more empirical and methodological than the typical Corporate Finance class. Students will also have to complete a larger empirical project as part of the requirements. (See below.)
**Course Assignments and Grading**

There will be a few longer assignments, at least one of which involves data work, most likely using Compustat. (Get a login now! See instructions at wrds.wharton.upenn.edu.) We will also have a mid-term and a final exam. They will contain theoretical and empirical questions about the material covered in class. The grade composition will be as follows:

- 40% for theoretical & empirical assignments;
- 20% for the midterm exam;
- 40% for the final exam;

Finally, I will count class participation (including evidence of intelligently reading the required papers and discussing them) by adding or subtracting up to 10 points to the rest of the grades.

For 3rd-years and higher (who have passed field exams and are preparing for orals or beyond): You can substitute the assignments with a paper. You should only do so if you are already working on a (serious) paper and are sure that you will be able to submit a complete paper at the end of the course.

(Even if you fall into this category, it is not clear you should choose this option. Hands-on work on problem sets is very often the start of a thesis paper …)

**Required Background**

As a general rule, you should have a solid training in econometrics at the level of 240A and 240B. For example, you should be familiar with OLS estimation, panel data models, and discrete-choice models, and you should have no uncertainty as to what fixed effects do in a regression. You will be required to use STATA for the mandatory homework assignment. Although it is not a requirement for this course, I strongly recommend taking at least one empirical course or course sequence: labor, public, development. In addition, I recommend 244 for advanced training in econometrics.

Second, the course draws heavily on contract theory and some game theory. I expect the first-year graduate sequence in micro-theory as background.

Third, I strongly recommend taking Adam Szeidl’s Asset Pricing class (234A). While not a prerequisite, it will ease the understanding of financial markets and finance-specific techniques such as the calculation of abnormal returns. If you are planning to take Financial Economics as a field, you have to take Asset Pricing. Also, if your main interest lies in the area of micro or macro theory you should take Asset Pricing. If, instead, your interest lies in the areas of labor economics / public finance / development / political economy / behavioral economics it is less crucial.

Fourth, I extra-strongly recommend going to finance-related seminars. Nothing conveys better what is new and exciting in finance than the ongoing research. There are two options. First of all, Haas has a regular finance seminar, held on Thursdays in Haas. Email me if you want to get on the distribution list of seminar announcements. Second, starting with this semester, I will organize a seminar in “Financial Economics.” This seminar serves two purposes: first, it
simply coordinates with neighboring fields (theory, public, development, psych & econ, labor) and points to those seminars with finance content. In those weeks, the seminar will be “joint with Financial Economics.” In addition, we also have a few speakers of our own. This semester, I mostly want to introduce the people who are doing finance-related research among the Berkeley faculty, e.g. Adam Szeidl, Ben Hermalin, Bob Anderson, Marko Tervio. So: please watch out for those announcements and try to go to at least one such seminar each week.

### Schedule of classes

<table>
<thead>
<tr>
<th>Date</th>
<th>Class</th>
<th>Topic</th>
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<tbody>
<tr>
<td>Tuesday, 1/16</td>
<td>1</td>
<td>Overview: Topics and Tool</td>
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<tr>
<td>Tuesday, 1/23</td>
<td>2</td>
<td>Internal Investment (1): Empirics; Financial Constraints</td>
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<tr>
<td>Tuesday, 1/30</td>
<td>3</td>
<td>Internal Investment (2): Asymmetric Information</td>
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<tr>
<td>Tuesday, 2/6</td>
<td>4</td>
<td>Internal Investment (2, continued): Asymmetric Information – other empirical applications &amp; theoretical treatment of debt Internal Investment (3): Agency</td>
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<tr>
<td>Tuesday, 2/13</td>
<td>5</td>
<td>Internal Investment (4): Overconfidence</td>
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<tr>
<td>Tuesday, 2/20</td>
<td>6</td>
<td>External Investment (2): Corporate Control and Voting</td>
</tr>
<tr>
<td>Tuesday, 2/27</td>
<td></td>
<td>Cancelled</td>
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<tr>
<td>Tuesday, 3/6</td>
<td>7</td>
<td>External Investment (4): Managerial Hubris</td>
</tr>
<tr>
<td>Tuesday, 3/13</td>
<td>8</td>
<td>Discussion of HW 1</td>
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<tr>
<td>Friday, 3/16</td>
<td>(extra)</td>
<td>Review Session Midterm</td>
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<tr>
<td>Room: Evans 639</td>
<td></td>
<td>Time: 3-5pm (I expect to need only 60 mins.)</td>
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<tr>
<td>Tuesday, 3/20</td>
<td>9</td>
<td>Mid-term</td>
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<tr>
<td>Tuesday, 3/27</td>
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<td>Spring Recess</td>
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<tr>
<td>Tuesday, 4/3</td>
<td>10</td>
<td>Finishing up Capital Structure (II): Asymmetric Information and Pecking Order Discussion of HW 2</td>
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<tr>
<td>Tuesday, 4/10</td>
<td>11</td>
<td>Capital Structure (III): Biased Managers</td>
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<tr>
<td>Tuesday, 4/17</td>
<td>12</td>
<td>Capital Structure (IV): Biased Investors [Market Timing]</td>
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<tr>
<td>Tuesday, 4/24</td>
<td>13</td>
<td>IPOs, SEOs, Dividends and Repurchases</td>
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<tr>
<td>Tuesday, 5/1</td>
<td>14</td>
<td>Discussion of HW 3</td>
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<tr>
<td>Wednesday</td>
<td>(extra)</td>
<td>Review Session Final exam</td>
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<tr>
<td>Room: Evans 608-7</td>
<td></td>
<td>Time: 3:30-5pm (I expect to need only 60 mins)</td>
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<tr>
<td>Tuesday, 5/8</td>
<td>15</td>
<td>Final exam</td>
</tr>
<tr>
<td>Thursday, 5/10</td>
<td>(extra)</td>
<td>Final exam (alternate date)</td>
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<tr>
<td>Room: Evans 639</td>
<td></td>
<td>Time: 12-2pm</td>
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Readings

Textbooks:
- Tirole, Corporate Finance.
- Hart, Firms, Contracts, and Financial Structure

Class 2 Internal Investment
A. Is investment sensitive to cash-flow?
B. Similar puzzles in other fields of economics: macro, development
C. Why is investment sensitive to cash-flow (I): Financial Constraints


Class 3 Internal Investment (II)
A. Introduction to WRDS and other finance-related data sets.
B. Why is investment sensitive to cash-flow (2): Asymmetric information

WRDS documentation!


Class 4 Internal Investment (III)
A. Why is investment sensitive to cash-flow (2 continued): Asymmetric information – more on the empirics (I/collateral sensitivity) and more on the theory (modeling debt)
B. Why is investment sensitive to cash-flow (3 + 4): Agency Costs and Overconfidence


**Class 5 Internal Investment (IV), External Investment (I)**

A. Why is investment sensitive to cash-flow (4): CEO Overconfidence


**Class 6 External Investment (II)**

A. External Investment (2): Free-riding theories

B. External Investment (3): Misvaluation theories


**Class 7 External Investment (III) + Capital Structure (I)**

A. External Investment (3, continued): Misvaluation theories & Empirical Tests

B. External Investment (4): Overvaluation theories (overconfidence) & Empirical Tests


**Class 8 Capital Structure (II)**

A. Capital Structure (2): Asymmetric information
B. Capital Structure (3): Pecking order


**Class 9 Capital Structure (III)**

A. Capital Structure (3): Managerial characteristics and managerial biases


**Class 10 Capital Structure (II)**

A. Capital Structure (4): Investor biases and market timing

Class 11 New Issues, Dividends, Repurchases

A. Stylized Facts about IPOs

B. Introduction to Corporate Governance and Executive Compensation


Ariely, Dan; Gneezy, Uri; Loewenstein, George; and Nina Mazar (2005). “Large Stakes and Big Mistakes,” Working Paper.


Class 12 Corporate Governance (I)


Class 13 Corporate Governance (II): Media


Class 14 Financial Distress


**Class 15 Law and Finance**


